NEOGENOMICS INC
Form 10-Q
August 07, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number: 001-35756

NEOGENOMICS, INC.

(Exact name of registrant as specified in its charter)

Nevada (State or other jurisdiction of incorporation or organization)	74-2897368 (I.R.S. Employer Identification No.)
12701 Commonwealth Drive, Suite 9, Fort Myers, Florida (Address of principal executive offices)	33913 (Zip Code)

(239) 768-0600

(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller Reporting Company
		Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of August 3, 2017, the registrant had 79,388,014 shares of Common Stock, par value $0.001 per share outstanding.

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FORWARD-LOOKING STATEMENTS

The information in this Quarterly Report on Form 10-Q contains "forward-looking statements" and information within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act") relating to NeoGenomics, Inc., a Nevada corporation and its subsidiaries, NeoGenomics Laboratories, Inc., a Florida corporation ("NEO", "NeoGenomics Laboratories"), NeoGenomics Bioinformatics Inc., a Florida corporation, and Clarient, Inc., a Delaware corporation and its wholly owned subsidiary, Clarient Diagnostic Services, Inc. (together "Clarient") (collectively referred to as "we", "us", "our", "NeoGenomics", or the "Company"), which are subject to the "safe harbor" created by those sections. These forward-looking statements include, but are not limited to, statements concerning our strategy, future operations, future financial position, future revenues, projected costs, prospects and plans and objectives of management. The words "anticipates," "believes," "estimates," "expects," "intends," "may," "plans," "projects," "will," "would" and similar expr intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. These forward-looking statements involve known and unknown risks and uncertainties that could cause our actual results, performance or achievements to differ materially from those expressed or implied by the forward-looking statements, including, without limitation, the risks set forth under "Risk Factors" and in Part I, Item 1A, "Risk Factors" contained in our Annual Report on Form 10-K as filed with the SEC on March 14, 2017.

Forward looking statements include, but are not limited to, statements about:

- Our ability to implement our business strategy;
- The expected reimbursement levels from governmental payers and private insurers and proposed changes to those levels;
- The application, to our business and the services we provide, of existing laws, rules and regulations, including without limitation, Medicare laws, anti-kickback laws, Health Insurance Portability and Accountability Act of 1996 regulations, state medical privacy laws, federal and state false claims laws and corporate practice of medicine laws;
- Regulatory developments in the United States including downward pressure on health care reimbursement;
- Our ability to maintain our license under the Clinical Laboratory Improvement Amendments of 1988 ("CLIA");
- Food and Drug Administration regulation of Laboratory Developed Tests ("LDTs");
- Failure to timely or accurately bill for our services;
- Our ability to expand our operations and increase our market share;
- Our ability to expand our service offerings by adding new testing capabilities;
- Our ability to meet our future capital requirements;
- Our ability to integrate future acquisitions and costs related to such acquisitions;
- The impact of internalization of testing by customers;
- Our ability to maintain service levels and compete with other diagnostic laboratories;
- Our ability to hire and retain sufficient managerial, sales, clinical and other personnel to meet our needs;
- Our ability to successfully scale our business, including expanding our facilities, our backup systems and infrastructure;
- The accuracy of our estimates regarding reimbursement, expenses, future revenues and capital requirements.

Any forward-looking statement speaks only as of the date on which such statement is made, and the Company undertakes no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time and it is not possible for management to predict all of such factors, nor can it assess the impact of each such factor on the business or the extent to which any factor, or combination of factors, may cause

actual results to differ materially from those contained in any forward-looking statements.

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NEOGENOMICS, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

(unaudited)

ASSETS	June 30, 2017	December 31, 2016
Current assets		
Cash and cash equivalents	$ 10,932	$ 12,525
Accounts receivable (net of allowance for doubtful accounts of $11,629 and $13,699, respectively)	61,750	55,512
Inventories	5,457	6,253
Other current assets	5,218	4,535
Total current assets	83,357	78,825
Property and equipment (net of accumulated depreciation of $34,604 and $27,102, respectively)	35,588	34,036
Intangible assets, net	73,614	77,064
Goodwill	147,019	147,019
Other assets	302	174
Total assets	$ 339,880	$ 337,118
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 15,594	$ 16,782
Accrued compensation	7,782	8,351
Accrued expenses and other liabilities	3,186	4,247
	4,812	4,891

Short-term portion of capital leases		
Short-term portion of loans	3,830	3,842
Total current liabilities	35,204	38,113
Long-term liabilities		
Long-term portion of capital leases	5,307	5,378
Long-term portion of loans, net	68,454	70,259
Revolving credit facility, net	26,906	21,799
Deferred income tax liability, net	7,435	14,973
Total long-term liabilities	108,102	112,409
Total liabilities	143,306	150,522
Commitments and contingencies - see Note I		
Redeemable convertible preferred stock		
Series A Redeemable Convertible Preferred Stock, $0.001 par value, (50,000,000 shares authorized; 6,600,000 shares issued and outstanding)	27,676	22,873
Stockholders' equity		
Common stock, $0.001 par value, (250,000,000 shares authorized; 79,340,374 and 78,571,158 shares issued and outstanding, respectively)	79	79
Additional paid-in capital	220,622	216,104
Accumulated deficit	(51,803)	(52,460)
Total stockholders’ equity	168,898	163,723
Total liabilities, redeemable convertible preferred stock and stockholders' equity	$ 339,880	$ 337,118

See notes to unaudited consolidated financial statements

NEOGENOMICS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
NET REVENUE				
Clinical testing	$59,791	$56,316	$116,482	$110,936
Pharma Services	6,299	6,813	11,285	11,896
Total Revenue	66,090	63,129	127,767	122,832
COST OF REVENUE	34,912	34,524	69,393	67,055
GROSS PROFIT	31,178	28,605	58,374	55,777
Operating expenses:				
General and administrative	22,675	18,779	43,476	36,785
Research and development	947	1,306	1,809	2,752
Sales and marketing	6,242	6,327	11,890	12,127
Total operating expenses	29,864	26,412	57,175	51,664
INCOME FROM OPERATIONS	1,314	2,193	1,199	4,113
Interest expense, net	1,411	1,448	2,775	3,040
Income (loss) before taxes	(97)	745	(1,576)	1,073
Income tax (benefit) expense	(54)	332	(879)	505
NET INCOME (LOSS)	(43)	413	(697)	568
Deemed dividends on preferred stock	929	1,840	1,822	3,680
Amortization of preferred stock beneficial conversion feature	1,710	3,727	3,383	7,453
NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS	$(2,682)	$(5,154)	$(5,902)	$(10,565)
NET LOSS PER SHARE ATTRIBUTABLE TO COMMON STOCKHOLDERS				
Basic	$(0.03)	$(0.07)	$(0.07)	$(0.14)
Diluted	$(0.03)	$(0.07)	$(0.07)	$(0.14)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic	79,413	77,448	79,075	76,758
Diluted	79,413	77,448	79,075	76,758

See notes to unaudited consolidated financial statements.

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NEOGENOMICS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	For the Six Months Ended June 30,	
CASH FLOWS FROM OPERATING ACTIVITIES	2017	2016
Net income (loss)	$(697)	$568
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	7,906	7,329
Amortization of intangibles	3,450	3,636
Amortization of debt issue costs	219	358
Stock based compensation – options, restricted stock and warrants	3,052	2,337
Provision for bad debts	8,027	5,434
Changes in assets and liabilities, net:		
(Increase) in accounts receivable, net of write-offs	(14,265)	(10,004)
(Increase) decrease in inventories	796	(437)
(Increase) in prepaid expenses	(720)	(602)
(Increase) in other current assets	(129)	—
Increase (decrease) in accounts payable and other liabilities	(2,797)	3,476
Net cash provided by operating activities	4,842	12,095
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(7,864)	(3,425)
Net cash used in investing activities	(7,864)	(3,425)
CASH FLOWS FROM FINANCING ACTIVITIES		
Advances from revolving credit facility, net	4,997	—
Repayment to revolving credit facility	—	(10,044)
Repayment of capital lease obligations/loans	(2,754)	(2,611)
Repayment on term loan, net	(1,878)	—
Proceeds from the exercise of options, warrants and ESPP shares, net of transaction expenses	1,176	2,351
Payments of equity issue costs	(112)	—
Net cash provided by (used in) financing activities	1,429	(10,304)
Net change in cash and cash equivalents	(1,593)	(1,634)
Cash and cash equivalent, beginning of period	12,525	23,420
Cash and cash equivalents, end of period	$10,932	$21,786
Supplemental disclosure of cash flow information:		
Interest paid	$2,573	$2,691
Income taxes paid	$102	$222
Supplemental disclosure of non-cash investing and financing information:		
Equipment acquired under capital lease/loan obligations	$2,557	$2,585

Deemed dividends on preferred stock	$1,822	$3,680
Amortization of preferred stock beneficial conversion feature	$3,383	$7,453

See notes to unaudited consolidated financial statements.

NEOGENOMICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

Note A – Nature of Business and Basis of Presentation

NeoGenomics, Inc., a Nevada corporation (the "Parent"), and its subsidiaries, NeoGenomics Laboratories, Inc., a Florida corporation ("NEO" or, "NeoGenomics Laboratories"), NeoGenomics Bioinformatics Inc., a Florida corporation, Path Labs LLC., a Delaware limited liability company ("PathLogic") and Clarient Inc., a Delaware corporation, and its wholly owned subsidiary Clarient Diagnostic Services, Inc. (together, "Clarient"), (collectively referred to as "we", "us", "our", "NeoGenomics", or the "Company"), operates as a certified "high complexity" clinical laboratory in accordance with the federal government's Clinical Laboratory Improvement Act, as amended ("CLIA"), and is dedicated to the delivery of clinical diagnostic services to pathologists, oncologists, urologists, hospitals, and other laboratories throughout the United States. On August 1, 2017, the Company completed the sale of its equity interests in Path Logic, see Note K – Subsequent Events.

The accompanying interim consolidated financial statements are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information. These accompanying interim consolidated financial statements include the accounts of the Parent and its subsidiaries. All intercompany transactions and balances have been eliminated in the accompanying interim consolidated financial statements.

Certain information and footnote disclosures normally included in the Company's annual audited consolidated financial statements and accompanying notes have been condensed or omitted in these accompanying interim consolidated financial statements. Accordingly, the accompanying interim consolidated financial statements included herein should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company's annual report on Form 10-K for the year ended December 31, 2016, filed with the SEC on March 14, 2017.

The results of operations presented in this quarterly report on Form 10-Q are not necessarily indicative of the results of operations that may be expected for any future periods. In the opinion of management, these unaudited consolidated financial statements include all adjustments and accruals, consisting only of normal recurring adjustments that are necessary for a fair statement of the results of all interim periods reported herein.

We have one reportable operating segment that delivers testing services to hospitals, pathologists, oncologists, other clinicians, and researchers, which represents 100% of the Company's consolidated assets, net revenues and net income (loss) for the three and six months ended June 30, 2017 and 2016. We have evaluated our segments based on how the Chief Operating Decision Maker ("CODM"), our Chief Executive Officer, reviews performance and makes decisions in managing the Company. At June 30, 2017, all of our services were provided within the United States and all of our assets were located in the United States.

We have two primary types of customers, clinical and pharma. Our clinical customers include community based pathology practices, oncology groups, hospitals and academic centers. Our pharma customers include pharmaceutical companies to whom we provide testing and other services to support their studies and clinical trials. As we grow, we continue to assess the information available to the CODM. Currently, discrete financial information is not available to the CODM about the separate financial performance of our clinical and our pharma customers. As we continue to grow and focus separately on the two customer types we will routinely assess the information available and reviewed by the CODM and determine if we meet the criteria for having separate segments.

Note B – Recently Adopted and Issued Accounting Guidance

Adopted

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU ") No. 2016-09, Improvements to Employee Share-Based Payment Accounting. The standard update required excess tax benefits and tax deficiencies to be recorded directly through earnings as a component of income tax expense. Under previous GAAP, these differences were generally recorded in additional paid-in capital and thus had no impact on net income. The change impacted the computation of diluted earnings per share, and the cash flows associated with those items are now classified as operating activities on the condensed statements of consolidated cash flows. Entities were permitted to make an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures could be estimated, as required under previous GAAP, or recognized when they occur.

NEOGENOMICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The Company adopted this ASU on January 1, 2017 using the transition method prescribed for each applicable provision:

- Based on the implementation guidance, previously unrecognized excess tax benefits should be on a modified retrospective basis beginning in the period the guidance is adopted. Accordingly, the Company recorded an increase in deferred tax assets and an offsetting cumulative-effect adjustment to retained earnings of $6.6 million as of January 1, 2017 for excess tax benefits not previously recognized.
- Based on the implementation guidance, all excess tax benefits and tax deficiencies related to share based compensation will be reported in net income (loss) on a prospective basis. For the six months ended June 30, 2017, no income (loss) was reported.
- The Company has elected to retrospectively adopt the requirement to present cash flows related to excess tax benefits as cash flows from operating activities. This adoption had no effect on cash flows for the six months ended June 30, 2017.
- The Company has elected to recognize forfeitures in compensation cost as they occur.

Issued

In May 2017, the FASB issued ASU 2017-09, Compensation – Stock Compensation. This standard provides guidance related to the scope of stock option modification accounting, to reduce diversity in practice and reduce cost and complexity regarding existing guidance. This update is effective for annual periods beginning after December 15, 2017. Early adoption is permitted. The Company does not expect the adoption of this guidance to have a material effect on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations. This standard clarifies the definition of a business and provides guidance on when transactions should be accounted for as acquisitions of assets and when they should be accounted for as acquisitions of businesses. This update is effective for periods beginning after December 15, 2017. Early adoption is permitted. The Company does not expect the adoption of this guidance to have a material effect on its consolidated financial statements.

In January 2017 the FASB issued ASU No. 2017-04, Intangibles – Goodwill and Other: Simplifying the Test for Goodwill Impairment. This standard eliminates Step 2 of the goodwill impairment test. Instead, an entity should perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. This update is effective for annual and interim periods beginning after December 15, 2021. Early adoption is permitted for interim or annual goodwill impairment tests performed after January 1, 2017. The Company

does not expect the adoption of ASU 2017-04 to have a material effect on its consolidated financial statements.

In August 2016, the FASB issued "ASU" 2016-15, Statement of Cash Flows – Classification of Certain Cash Receipts and Cash Payments. This standard clarifies how specific cash receipts and cash payments are classified and presented in the statement of cash flows. This update is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2017. Early adoption is permitted. The Company does not expect the adoption of ASU 2016-15 to have a material effect on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases. The update requires organizations to recognize lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. ASU 2016-02 requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. ASU 2016-02 is effective for periods beginning after December 15, 2018 and interim periods within those periods. The adoption of this ASU will result in an increase on the balance sheet for lease liabilities and right to use assets. The Company is currently evaluating the quantitative impact that adopting ASU 2016-02 will have on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenues from Contracts with Customers. This standard update calls for a number of revisions in the revenue recognition rules. In August 2015, the FASB deferred the effective date of this ASU to the first quarter of 2018, with early adoption permitted beginning in the first quarter of 2017. The ASU can be applied using a full retrospective method or a modified retrospective method of adoption. The Company expects to adopt this ASU in the first quarter of 2018 using a full retrospective method of adoption. We anticipate enhanced financial statement disclosures surrounding the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In addition, we expect the standard to impact gross profit as a portion of our bad debt expense will be considered an implicit price concession and will be reported as a reduction in net

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revenue, versus part of selling, general and administrative expenses. The Company is currently performing a detailed contract review in order to determine the quantitative impact of this standard.

Note C – Goodwill and Intangible Assets

Goodwill as of June 30, 2017 and December 31, 2016 was $147.0 million. There were no changes in the carrying amount of goodwill during these periods.

Intangible assets as of June 30, 2017 and December 31, 2016 consisted of the following (in thousands):

		June 30, 2017		
	Amortization Period	Cost	Accumulated Amortization	Net
Trade Name	24 months	$3,000	$ 2,258	$742
Customer Relationships	156 - 180 months	81,000	8,128	72,872
Total		$84,000	$ 10,386	$73,614

		December 31, 2016		
	Amortization Period	Cost	Accumulated Amortization	Net
Trade Name	24 months	$3,000	$ 1,508	$1,492
Customer Relationships	156 - 180 months	$81,000	$ 5,428	$75,572
Total		$84,000	$ 6,936	$77,064

We recorded approximately $1.7 and $1.6 million in straight-line amortization expense of intangible assets for the three month period ended June 30, 2017 and 2016, respectively. We recorded approximately $3.5 million and $3.6 million in straight-line amortization expense of intangible assets for the six month period ended June 30, 2017 and 2016, respectively. The Company recorded amortization expense from customer relationships and trade names as a general and administrative expense.

The estimated amortization expense related to amortizable intangible assets for each of the five succeeding fiscal years and thereafter as of June 30, 2017 is as follows (in thousands):

Remainder of 2017	$3,442
2018	5,400
2019	5,400
2020	5,400
2021	5,400
Thereafter	48,572
Total	$73,614

Note D – Debt

The following table summarizes the long term debt at June 30, 2017 and December 31, 2016 (in thousands):

	June 30, 2017	December 31, 2016
Term Loan Facility	$73,125	$75,000
Revolving Credit Facility	27,900	22,900
Auto Loans	154	202
Capital leases	10,119	10,269
Total Debt	111,298	108,371
Less: Debt issuance costs	(1,989)	(2,202)
Less: Current portion of long-term debt	(8,642)	(8,733)
Total Long-Term Debt, net	$100,667	$97,436

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The carrying value of the Company's long-term capital lease obligations and term debt approximates its fair value based on the current market conditions for similar instruments.

Term Loan

On December 22, 2016, the Company entered into a Credit Agreement with Regions Bank as administrative agent and collateral agent. The Credit Agreement provided for a $75.0 million term loan facility (the "Term Loan Facility"). The Credit Agreement also provides incremental facility capacity of $50 million, subject to certain conditions. On June 30, 2017 and December 31, 2016, the Company had current outstanding borrowings under the Term Loan of approximately $3.8 million and long-term outstanding borrowings of approximately $68.4 million and $70.1 million, net of unamortized debt issuance costs of $994,000 and $1.1 million, respectively. The debt issuance costs were recorded as a reduction in the carrying amount of the related liability and are being amortized over the life of the loan.

The Term Loan Facility bears interest at a rate per annum equal to an applicable margin plus, at NeoGenomics Laboratories' option, either (1) the Adjusted LIBOR rate for the relevant interest period, (2) an alternate base rate determined by reference to the greatest of (a) the prime lending rate of Regions, (b) the federal funds rate for the relevant interest period plus 0.5% per annum and (c) the one month LIBOR rate plus 1% per annum, or (3) a combination of (1) and (2). The applicable margin will range from 2.25% to 3.50% for LIBOR loans and 1.25% to 2.50% for base rate loans, in each case based on NeoGenomics Laboratories' consolidated leverage ratio (as defined in the Credit Agreement). Interest on borrowings under the Revolving Credit Facility is payable on the last day of each month, in the case of each base rate loan, and on the last day of each interest period (but no less frequently than every three months), in the case of Adjusted LIBOR loans. The Company entered into an interest rate swap agreement to hedge against changes in the variable rate of a portion of this debt. See Note E-Derivative Instruments and Hedging Activities for more information on this instrument.

The Term Loan Facility and amounts borrowed under the Revolving Credit Facility are secured on a first priority basis by a security interest in substantially all of the tangible and intangible assets of NeoGenomics Laboratories and the Guarantors. The Term Loan Facility contains various affirmative and negative covenants including ability to incur liens and encumbrances; make certain restricted payments, including paying dividends on its equity securities or payments to redeem, repurchase or retire its equity securities; enter into certain restrictive agreements; make investments, loans and acquisitions; merge or consolidate with any other person; dispose of assets; enter into sale and leaseback transactions; engage in transactions with its affiliates, and materially alter the business it conducts. In addition, the Company must meet certain maximum leverage ratios and fixed charge coverage ratios as of the end of each fiscal quarter commencing with the quarter ending March 31, 2017. The Company was in compliance with all required covenants as of June 30, 2017.

The Term Loan Facility has a maturity date of December 21, 2021. The Credit Agreement requires NeoGenomics Laboratories to mandatorily prepay the Term Loan Facility and amounts borrowed under the Revolving Credit Facility with (i) 100% of net cash proceeds from certain sales and dispositions, subject to certain reinvestment rights, (ii) 100% of net cash proceeds from certain issuances or incurrences of additional debt, (iii) beginning with the fiscal year ending December 31, 2017, 50% of excess cash flow (as defined), subject to a step down to 0% of excess cash flow if NeoGenomics Laboratories' consolidated leverage ratio is no greater than 2.75:1.0 and (iv) 100% of net cash proceeds from issuances of permitted equity securities by NeoGenomics Laboratories made in order to cure a failure to comply with the financial covenants. NeoGenomics Laboratories is permitted to voluntarily prepay the Term Loan Facility and amounts borrowed under the Revolving Credit Facility at any time without penalty.

Auto Loans

The Company has auto loans with various financial institutions. The auto loan terms range from 36-60 months and carry interest rates from 0.0% to 5.2%.

Capital Leases

The Company has entered into capital leases to purchase laboratory and office equipment. These leases expire at various dates through 2020 and the weighted average interest rate under such leases was approximately 5.64% at June 30, 2017. Most of these

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

leases contain bargain purchase options that allow us to purchase the leased property for a minimal amount upon the expiration of the lease term. The remaining leases have purchase options at fair market value.

Property and equipment acquired under capital lease agreements are pledged as collateral to secure the performance of the future minimum lease payments.

Revolving Credit Facility

On December 22, 2016, the Company entered into a Credit Agreement with Regions Bank as administrative agent and collateral agent. The Credit Agreement provided for a $75.0 million revolving credit facility (the "Revolving Facility"). On June 30, 2017, and December 31, 2016, the Company had outstanding borrowings of approximately $26.9 million and $21.8 million, net of unamortized debt issuance costs of $995,000 and $1.1 million, respectively.

The Revolving Credit Facility includes a $10 million swingline sublimit, with swingline loans bearing interest at the alternate base rate plus the applicable margin. Any principal outstanding under the Revolving Credit Facility is due and payable on December 21, 2021 or such earlier date as the obligations under the Credit Agreement become due and payable pursuant to the terms of the Credit Agreement. The Revolving Facility bears interest at a rate per annum equal to an applicable margin plus, at NeoGenomics Laboratories' option, either (1) the Adjusted LIBOR rate for the relevant interest period, (2) an alternate base rate determined by reference to the greatest of (a) the prime lending rate of Regions, (b) the federal funds rate for the relevant interest period plus 0.5% per annum and (c) the one month LIBOR rate plus 1% per annum, or (3) a combination of (1) and (2). The applicable margin will range from 2.25% to 3.50% for Adjusted LIBOR loans and 1.25% to 2.50% for base rate loans, in each case based on NeoGenomics Laboratories' consolidated leverage ratio. Interest on the outstanding principal of the Term Loan Facility will be payable on the last day of each month, in the case of each base rate loan, and on the last day of each interest period (but no less frequently than every three months), in the case of LIBOR loans.

The Credit Agreement requires NeoGenomics Laboratories to mandatorily prepay the Term Loan Facility and amounts borrowed under the Revolving Credit Facility with (i) 100% of net cash proceeds from certain sales and dispositions, subject to certain reinvestment rights, (ii) 100% of net cash proceeds from certain issuances or incurrences of additional debt, (iii) beginning with the fiscal year ending December 31, 2017, 50% of excess cash flow (minus certain specified other payments), subject to a step down to 0% of excess cash flow if NeoGenomics Laboratories' consolidated leverage ratio is no greater than 2.75:1.0 and (iv) 100% of net cash proceeds from issuances of permitted equity securities by NeoGenomics Laboratories made in order to cure a failure to comply with the financial covenants. NeoGenomics Laboratories is permitted to voluntarily prepay the Term Loan Facility and amounts borrowed under the Revolving Credit Facility at any time without penalty, subject to customary "breakage"

costs with respect to prepayments of Adjusted LIBOR rate loans made on a day other than the last day of any applicable interest period.

Maturities of Long-Term Debt

Maturities of long-term debt at June 30, 2017 are summarized as follows (in thousands):

	Term Loan and Revolving Credit Facility	Capital Lease Obligations	Auto Loans	Total Long-Term Debt
Remainder of 2017	$ 1,875	$ 2,836	$ 45	$ 4,756
2018	3,750	4,533	69	8,352
2019	5,625	2,968	35	8,628
2020	5,625	454	5	6,084
2021	84,150	-	-	84,150
	101,025	10,791	154	111,970
Less: Interest on capital leases	-	(672)	-	(672)
	101,025	10,119	154	111,298
Less: Current portion of long-term debt	(3,750)	(4,812)	(80)	(8,642)
Less: Debt issuance costs	(1,989)	-	-	(1,989)
Long-term debt, net	$ 95,286	$ 5,307	$ 74	$ 100,667

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Note E – Derivative Instruments and Hedging Activities

Cash Flow Hedges

In December of 2016, the Company entered into an interest rate swap agreement to reduce our exposure to interest rate fluctuations on our variable rate debt obligations. This derivative financial instrument is accounted for at fair value as a cash flow hedge which effectively modifies our exposure to interest rate risk by converting a portion of our floating rate debt to a fixed rate obligation, thus reducing the impact of interest rate changes on future interest expense.

We account for derivatives in accordance with FASB ASC Topic 815, see Note B-Summary of Significant Accounting Policies in Annual Report on Form 10-K for more information on our accounting policy related to derivative instruments and hedging activities.

Under this agreement, we receive a variable rate of interest based on LIBOR, and we pay a fixed rate of interest at 1.59%. The interest rate swap agreement was effective as of December 30, 2016 and a termination date of December 31, 2019. As of June 30, 2017 and December 31, 2016, the total notional amount of the Company’s interest rate swaps were $50 million.

The fair value of the interest rate swap will be included in other long term assets or liabilities, when applicable. As of June 30, 2017 and December 31, 2016, the fair value of the interest rate swap was not considered to be significant due to the change in LIBOR over that time period outstanding, therefore, no amount is included on the balance sheet for this instrument. As the specific terms and notional amounts of the derivative financial instrument match those of the fixed-rate debt being hedged, the derivative instruments are assumed to be perfectly effective hedges and accordingly, there is no impact to the Company's consolidated statements of operations. Gains and losses on this interest rate swap agreement will be recorded in accumulated other comprehensive income and will be reclassified to interest expense in the period during which the hedged transaction affects earnings. At June 30, 2017 and December 31, 2016, there was no impact to accumulated other comprehensive income (AOCI) as it was determined that there was not a significant change to record. The fair value of this instrument will be evaluated on a quarterly basis and adjusted as necessary.

Note F – Class A Redeemable Convertible Preferred Stock

On December 30, 2015, NeoGenomics issued 14,666,667 shares of its Series A Preferred stock as part of the consideration for the acquisition of Clarient. The Series A Preferred Stock has a face value of $7.50 per share for a total liquidation value of $110 million. During the first year, the Series A Preferred Stock had a liquidation value of $100 million if the shares were redeemed prior to December 29, 2016. On December 22, 2016, the Company redeemed 8,066,667 shares of the Series A Preferred Stock for $55.0 million in cash. The redemption amount per share equaled $6.8181825 ($7.50 minus the liquidation discount of 9.0909%). At June 30, 2017, 6,600,000 shares of Series A Preferred Stock were outstanding.

The carrying amount of the Series A Preferred Stock at June 30, 2017 was $27.7 million as compared to the carrying amount at December 31, 2016 of $22.9 million. The increase in the carrying amount is due to the accrual of deemed dividends of approximately $1.8 million, the accretion of the beneficial conversion feature of approximately $3.4 million during the six months ending June 30, 2017 and the additional BCF discounts for payment-in-kind shares accrued during the six months ending June 30, 2017 of $0.4 million. Both the deemed dividends and the accretion of the beneficial conversion feature are recorded as distributions to the holders of the Series A Preferred Stock on the income statement with the corresponding entry recorded as an increase to the carrying value of the Series A Preferred Stock.

Issue Discount

The Company recorded the Series A Preferred Stock at a fair value of approximately $73.2 million or $4.99 per share on the date of issuance. The difference between the fair value of $73.2 million and the liquidation value of $110 million represents a discount of $36.8 million from the initial face value as a result of assessing the impact the rights and features of the instrument and their effect on the value to the Company. After redemption, the Series A Preferred stock has a fair value of approximately $32.9 million or $4.99 per share. The difference between the fair value of $32.9 million and the liquidation value of $49.5 million represents a discount of approximately $16.6 million.

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Beneficial Conversion Features

The fair value of the common stock into which the Series A Preferred Stock is convertible exceeded the allocated purchase price fair value of the Series A Preferred Stock at the date of issuance and after redemption by approximately $44.7 and $20.1 million, respectively, resulting in a beneficial conversion feature. The Company will recognize the beneficial conversion feature as non-cash, deemed dividend to the holder of Series A Preferred Stock over the first three years the Series A Preferred Stock is outstanding, as the date the stock first becomes convertible is three years from the issue date. The amount recognized for the three and six months ended June 30, 2017 was approximately $1.7 million and $3.4 million, respectively.

In addition to the beneficial conversion feature ("BCF") recorded at the original issue date, we recorded additional BCF discounts for payment-in-kind shares accrued for quarters ended March 31, 2017 and June 30, 2017, as dividends. After the early redemption, the face value of the remaining Series A Preferred Stock is $49.5 million. We will issue 264,000 additional shares ($49.5 million * 4.0%) / $7.50) of Series A Preferred Stock as payment-in-kind dividends for the year ending December 31, 2017, the first year dividends are payable. The additional 264,000 shares will be discounted and amortized to the income statement over the remaining period up to the earliest conversion date, which is three years from the original issue date. The additional BCF discount recorded for the three and six months ended June 30, 2017 was approximately $201,240 and $402,480, respectively.

Automatic Conversion

Each share of Series A Preferred Stock issued and outstanding as of the tenth anniversary of the original issue date will automatically convert into fully paid and non-assessable shares of common stock.

Classification

The Company classified the Series A Preferred Stock as temporary equity on the consolidated balance sheets due to certain change in control events that are outside the Company's control, including deemed liquidation events described in the Series A Certificate of Designation.

Note G – Revenue Recognition and Contractual Adjustments

The Company recognizes revenues when (a) the price is fixed or determinable, (b) persuasive evidence of an arrangement exists, (c) the service is performed and (d) collectability of the resulting receivable is reasonably assured. The Company's specialized diagnostic services are performed based on a written test requisition form or electronic equivalent, and revenues are recognized once the diagnostic services have been performed, and the results have been delivered to the ordering physician. These diagnostic services are billed to various payers, including Medicare, commercial insurance companies, other directly billed healthcare institutions such as hospitals and clinics, and individuals. The Company reports revenues from contracted payers, including Medicare, certain insurance companies and certain healthcare institutions, based on the contractual rate, or in the case of Medicare, published fee schedules. The Company reports revenues from non-contracted payers, including certain insurance companies and individuals, based on the amount expected to be collected. The difference between the amount billed and the amount estimated to be collected from non-contracted payers is recorded as an allowance to arrive at the reported net revenues. The expected revenues from non-contracted payers are based on the historical collection experience of each payer or payer group, as appropriate. The Company records revenues from patient pay tests net of a large discount and as a result recognizes minimal revenue on those tests. The Company regularly reviews its historical collection experience for non-contracted payers and adjusts its expected revenues for current and subsequent periods accordingly. On January 1, 2017, we had a significant reduction in our patient fee schedule that primarily impacts the amount billed to uninsured patients.

The table below shows the adjustments made to gross service revenues to arrive at net revenues (in thousands), the amount reported on our statements of operations.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Gross service revenues	$93,862	$129,235	$177,800	$261,955
Total contractual adjustments and discounts	(27,772)	(66,106)	(50,033)	(139,123)
Net revenues	$66,090	$63,129	$127,767	$122,832

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Note H – Equity

A summary of the stock option activity under the Company's plans for the three months ended June 30, 2017 is as follows:

	Number of shares	Weighted average exercise price
Options outstanding at December 31, 2016	5,136,110	$ 5.76
Options granted	1,993,998	7.54
Less:		
Options exercised	329,819	3.14
Options canceled or expired	53,265	2.34
Options outstanding at June 30, 2017	6,747,024	6.44
Exercisable at June 30, 2017	2,195,147	5.33

Of the 6,747,024 outstanding options at June 30, 2017, 1,240,834 were variable accounted stock options issued to non-employees of the Company of which 453,333 options were vested and 787,501 options were unvested as of June 30, 2017.

The fair value of each stock option award granted during the six months ended June 30, 2017 was estimated as of the grant date using a trinomial lattice model with the following weighted average assumptions:

	Six Months Ended June 30, 2017
Expected term (in years)	3.0 - 4.0
Risk-free interest rate (%)	1.3%
Expected volatility (%)	47.6% - 53.0%
Dividend yield (%)	0.0%
Weighted average fair value/share at grant date	$ 2.23

As of June 30, 2017, there was approximately $7.7 million of unrecognized share based compensation expense related to stock options that will be recognized over a weighted-average period of approximately 1.3 years. This includes approximately $1.6 million in unrecognized expense related to the 787,501 shares of unvested variable accounted for stock options subject to fair value adjustment at the end of each reporting period based on changes in the Company's stock price.

Stock based compensation expense recognized for stock options and restricted stock and included in the consolidated statements of operations was allocated as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Research and development expense	$285	$372	$327	$363
General and administrative expense	1,637	1,188	2,725	1,985
Total stock based compensation expense	$1,922	$1,560	$3,052	$2,348

Stock based compensation recorded in research and development relates to unvested options granted to a non-employee.

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Common Stock Warrants

A summary of the warrant activity for the six months ended June 30, 2017 is as follows:

	Number of shares	Weighted average exercise price
Warrants outstanding at December 31, 2016	450,000	$ 1.50
Warrants granted	—	—
Less:		
Warrants exercised	450,000	1.50
Warrants canceled or expired	—	—
Warrants outstanding at June 30, 2017	—	—
Exercisable at June 30, 2017	—	—